United States Court of Appeals

for the Second Circuit

AMICUS BRIEF

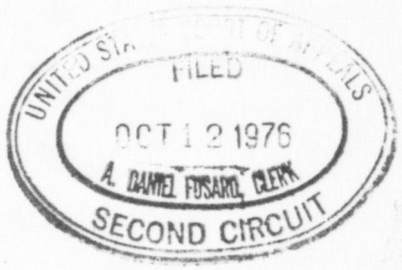
75-7608

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket No. 75-7608



IRVING SANDERS, *Plaintiff-Appellee,*

—against—

LEON LEVY, *et al., Defendants-Appellants.*

EGON TAUSSIG, *Plaintiff-Appellee,*

—against—

SIDNEY M. ROBBINS, *et al., Defendants-Appellants.*

MICHAEL SHAEV and RITA SHAEV, *Plaintiffs-Appellees,*

—against—

ERIC HAUSER, *et al., Defendants-Appellants.*

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK
(ON REHEARING IN BANC)

BRIEF OF AMERICAN COLLEGE OF TRIAL LAWYERS AS AMICUS CURIAE

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October 12, 1976

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Preliminary Statement

This brief is submitted on behalf of the American College of Trial Lawyers (the "College") as amicus curiae pursuant to leave of Court granted on September 27, 1976.

The College is a national organization of trial attorneys, each of whom is admitted to practice before the highest court in his state and each of whom has been actively engaged in trial practice for at least 15 years. Among the objects of the College is "to improve and enhance the standards of trial practice [and] the administration of justice". Article II, By-Laws of the College. In furtherance of that objective, the College in 1970 established a special Committee on Rule 23 and Multidistrict Litigation to engage in a continuing evaluation of Rule 23 and to recommend appropriate revisions. The Executive Committee of the College, acting for the Board of Regents, has authorized the special Committee to file this brief amicus curiae in order to present to the Court the College's views concerning the broad policy considerations raised by the question (whether to allocate the costs of identifying potential class members) decided by this Court's three-judge panel.

Question Presented

The College will address itself in this brief amicus curiae solely to the following question:

> Can class action defendants who have fiduciary duties to plaintiffs be compelled, absent special circumstances, to pay the initial costs of identifying putative class members when there has been no adjudication on the merits?

Although agreeing with the majority of this Court's three-judge panel that this question must be answered in the negative, the College respectfully submits that neither the majority opinion nor the dissenting opinion focussed sufficiently on what we believe to be the fundamental issue implicit in the question.

The critical issue, we suggest, is not whether the parties stand in a fiduciary or adversarial relationship or whether the rules of discovery are applicable to the process of identifying the class members. Nor is the issue one of the extent of the District Court's discretion, as plaintiffs contend. Rather, the basic question is how best to insure that defendants' constitutional rights under the Fifth and Seventh Amendments are not inadvertently infringed or sacrificed by the courts in their efforts to implement and apply Rule 23.

Argument

THE MAJORITY CORRECTLY HELD THAT THE COSTS OF IDENTIFYING CLASS MEMBERS SHOULD IN THE FIRST INSTANCE BE BORNE BY THE PLAINTIFFS.

Regardless of the existence of a fiduciary relationship between the parties to a class action, absent special circumstances (which are not present here) the costs of identifying and giving notice to class members cannot be imposed in the first instance on defendants without raising serious constitutional problems.* As Judge Mansfield has pointed out,

> "[t]o give a single member of a class . . . the power to trigger such a substantial expenditure . . . smacks of confiscation." Berland v. Mack, 48 F.R.D 121, 132 (S.D.N.Y. 1969).

It is the risk of just such "confiscation" which is the critical issue in the case at bar: defendants have not been adjudicated liable for any wrongdoing, and plaintiffs apparently are not only unwilling but are unable to reimburse defendants in the event that defendants ultimately prevail. See, e.g., Joint Appendix at 144, 149. To require defendants to pay the costs of identifying class members in these circumstances would thus do more than

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* The question of "special circumstances" is discussed infra at 16-19.

"compel . . . [them] to provide financial support for a class action against themselves," Slip Opinion at 4581; it would effectively preclude them from ever recovering the funds expended. This, we submit, would violate defendants' constitutional rights.*

However desirable the objectives of amended Rule 23, those objectives cannot and should not be accomplished at the expense of taking a defendant's property in violation of his right to trial under the Seventh Amendment and to due process under the Fifth Amendment. It was this very point which this Court emphasized in Eisen III when it cautioned that,

> ". . . statements about . . . providing a remedy for the ills of mankind do little to solve specific legal problems. The result of this approach is almost always confusion of thought and irrational, emotional and unsound decisions. In cases involving claims of money damages all litigation presumes a desire on the part of the judicial establishment to make the wrongdoer pay for the wrongs he has committed, but . . . none of these considerations justifies disregarding, nullifying or watering down any of the procedural safeguards established by the Constitution, or by congressional mandate, or by the Federal Rules of Civil Procedure, including amended Rule 23. It is a historical fact that procedural safeguards for the benefit of all litigants constitute some of the most

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* It was apparently this very constitutional problem which led Judge Hays to concur in Eisen III, "since," as he explained, "if the defendants should finally prevail, they would not be reimbursed for this expenditure." Eisen v. Carlisle & Jacquelin, 479 F.2d 1005, 1020 (2d Cir. 1973) ("Eisen III"), aff'd, 417 U.S. 156 (1974) ("Eisen IV").

> important and salutary protections against oppressions, including oppressions by those whose intentions may be above reproach." 479 F.2d at 1013. (Emphasis added.)

To the same effect was the warning by Mr. Justice Holmes, that "a strong public desire to improve the public condition is not enough to warrant achieving the desire by a shorter cut than the constitutional way of paying for the change." Pennsylvania Coal Co. v. Mahon, 260 U.S. 393, 416 (1923).*

Notwithstanding the obvious constitutional problems here, plaintiffs have put forward at least three general arguments as to why "a shorter cut" may be justi-

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* The primary objective of amended Rule 23 is not, as plaintiffs and some courts have mistakenly assumed, to provide a forum for litigants who otherwise could not afford to sue. See Joint Appendix at 126. Rather, the preeminent purpose was to concentrate in a single forum multitudinous claims which otherwise would be litigated separately in many state and federal courts. Advisory Committee's Note, Proposed Rules of Civil Procedure, 39 F.R.D. 98, 102-03 (1966). In other words, the Rule was designed primarily to benefit the courts, not plaintiffs; it was certainly not intended to add monumental burdens to already crowded dockets or to convert the District Courts into small claims courts. See generally American College of Trial Lawyers, Report and Recommendations of the Special Committee on Rule 23 of the Federal Rules of Civil Procedure (1972). As Judge Friendly sagely observed, "Something seems to have gone radically wrong with a well-intentioned effort. . . . [A]n injured plaintiff should be compensated, but the federal judicial system is not adapted to affording compensation to classes of hundreds of people with $10 or even $50 claims." Friendly, Federal Jurisdiction: A General View 120 (1973). The average claim of each class member in this case is about $15. See Joint Appendix at 152.

fied in the case at bar:

(1) The mere existence of a fiduciary relationship between the parties justifies abandoning "the usual rules . . . [in order] to insure that the trust relationship is not abused." Slip Opinion at 4596-97 (Hays, J., dissenting).

(2) The process of identifying class members is to be distinguished from the process of giving notice, since the former can be accomplished by traditional discovery procedures and hence can be left to "the sound discretion of the district judge." Id. at 4594.

(3) The interest of class action defendants, including these defendants, in obtaining as broad a res judicata effect as possible justifies imposing upon them the costs of insuring that appropriate notice is given to the class.

The College submits that none of these considerations justifies "disregarding, nullifying or watering down any of the procedural safeguards established by the Constitution . . . for the benefit of all litigants", 479 F.2d at 1013, including class action defendants. Indeed, concentrating undue attention on these factors only tends to obfuscate

the underlying issue of the due process problem inherent in ordering a defendant to pay for notice costs before an adjudication on the merits. See generally Note, Eisen III: Fluid Recovery, Constructive Notice and Payment of Notice Costs by Defendant in Class Action Rejected, 73 Colum. L. Rev. 1641, 1654 (1973). This is a problem, we believe, which must be faced directly and which in most instances must be resolved in favor of the defendant.*

A. The Existence of a Fiduciary Duty Does not Justify Imposing Costs of Notice on Defendants

Much of the confusion regarding the significance (or lack thereof) of a fiduciary relationship between the parties to a class action apparently arises out of a statement by the Supreme Court in Eisen IV:

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* The College submits that, in addition to the constitutional infirmity of the position urged by plaintiffs here, a requirement that defendants advance identification costs (which they cannot expect to recover even if they are successful in the litigation) is a substantive and not a procedural matter. Such a requirement, therefore, would be inconsistent with the Enabling Act, 28 U.S.C. § 2072, under which Rule 23 was promulgated. That Act specifies that rules prescribed by the Supreme Court for the District Courts "shall not abridge, enlarge or modify any substantive right," and the Supreme Court has held in Snyder v. Harris, 394 U.S. 332 (1969), that Rule 23 does not and cannot affect a change in substantive law. See generally, Simon, Class Actions--Useful Tool or Engine of Destruction, 55 F.R.D. 375, 386 (1972). Indeed, it was in part because of the mandate of the Enabling Act that this Court refused to impose the costs of notice upon the defendants in Eisen III. See 479 F.2d at 1014.

> "The usual rule is that a plaintiff must initially bear the cost of notice to the class. The exceptions cited by the District Court related to situations where a fiduciary duty pre-existed between the plaintiff and defendant, as in a shareholder derivative suit. 15/ Where, as here, the relationship between the parties is truly adversary, the plaintiff must pay for the cost of notice as part of the ordinary burden of financing his own suit."
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> "15/ See, e.g., Dolgow v. Anderson, 43 F.R.D. 472, 498-500 (EDNY 1968). We, of course, express no opinion on the proper allocation of the cost of notice in such cases." Eisen v. Carlisle & Jacquelin, 417 U.S. at 178-79.

We submit that, except in highly unusual circumstances not present here, the issue left open by the Supreme Court in footnote 15 in Eisen IV must be resolved in favor of defendants. Indeed, we suggest that in most class actions the existence or non-existence of a fiduciary relationship between the parties will and should be totally irrelevant to the determination of who in the first instance must bear the cost of identifying or giving notice to the class.

A fortiorari, this is true in the case at bar. As Judge Palmieri was careful to point out, the particular fiduciary upon which the notification costs were imposed --that is, the Fund--"is not a party to the class action claims" and is not alleged to have breached any fiduciary obligations to the putative class; no recovery is sought

from the Fund in the class action, and the Fund "would not directly benefit from a recovery" even under the derivative claims. Slip Opinion at 4583. No theory of logic, law or equity, therefore, would justify imposing the identification costs upon the Fund. Nor, we submit, would any such theory justify the imposition of costs upon the other defendants, including those who arguably might have a fiduciary relationship to the members of the class.

The fact that the parties to a class action may stand in a fiduciary relationship does not, in substantially all cases, mean that the relationship is not "truly adversary". True, a fiduciary--whether a trustee or a mutual fund or a majority shareholder--may in his commercial dealings be held "to something stricter than the morals of the market place" and to "the punctilio of an honor the most sensitive". Meinhard v. Salmon, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928). But he is not required to surrender his constitutional right to due process merely because he is a fiduciary and merely because a disgruntled beneficiary or shareholder decides to sue him. Whatever the duty he owes to that beneficiary or shareholder in the course of their business dealings, their relationship in virtually all litigations is "truly adversary" and should be so recognized. In other words, as Judge Mansfield correctly concluded,

a "corporate defendant should [not] be required initially to pay for the notice merely because charges of breach of fiduciary duty are at issue . . . ." Berland v. Mack, supra, 48 F.R.D. at 131-32. (Emphasis added.) Indeed, it would be an "abuse of the corporate treasury" for a court to compel the "use of corporate funds for vindication of an issue as to fiduciary duty merely because it [was] raised by one" of the corporation's shareholders. Ibid.

Nothing in the Supreme Court's statement in Eisen IV is inconsistent with this analysis; quite the contrary. For example, the Supreme Court referred to a pre-existing fiduciary duty only "as in a shareholder derivative suit". But a derivative action is different from a class action. As Judge Palmieri pointed out in the case at bar, the corporation in a derivative suit, "though a nominal defendant, has interests closely aligned with the plaintiff and indeed would be the beneficiary of any recovery." Slip Opinion at 4582-83.* Moreover, the notice requirements in the two types of actions are also differ-

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* The College has not addressed itself to Judge Palmieri's statement that "the equities in favor of imposing some costs on the corporation in . . . [the derivative action] are obvious." Ibid. Suffice it to note that, as a practical matter, it is frequently not in the corporation's best interests to have a derivative suit maintained on its behalf.

ent. In a class action notice of pendency must ordinarily be given at the outset of the litigation and must be "the best notice practicable under the circumstances", whereas notice in a derivative action is not required until the action is being dismissed or compromised and even then is given only "in such manner as the court directs." By that time, of course, there has been either an adjudication or a settlement, and the court--knowing what benefits, if any, the corporation will receive--is in a better position to resolve the question of allocating costs in a manner which avoids infringing upon the constitutional rights of the parties.

In addition to the reference to derivative actions, the Supreme Court in Eisen IV cited Dolgow v. Anderson, a class action. In Dolgow, however, Judge Weinstein was careful to conclude that a defendant fiduciary could be compelled initially to bear certain notice costs only when "the plaintiffs are [first] able to convince the Court [at a preliminary hearing] that there is a substantial possibility that they will prevail on the merits." 43 F.R.D. at 501. Eisen IV now permits no such preliminary hearing. Indeed, plaintiffs here acknowledge that "the strength" of their case is an "inappropriate" consideration in determining who should pay for identifying and giving notice to the class. Peti-

tion for Rehearing at 5.

The question left open by the Supreme Court in Eisen IV, therefore, does not relate to actions like the case at bar. On the facts of this case, the question must be resolved by applying "the usual rule".

B. Identifying Class Members Is an Integral Step in the Process of Giving Notice

The College agrees with the majority of this Court's three-judge panel that "the cost of obtaining the name and address to be affixed to the envelope does not differ in kind from the cost of printing the notice and of procuring, stuffing and posting the envelopes." Slip Opinion at 4587. We agree for the following reasons:

(1) Apart from the question of numerosity (which does not involve the identities but only the number of potential members), the names and addresses of class members will seldom, if ever, be a proper subject for the discovery which a plaintiff may be entitled to conduct in connection with his motion for a class determination. (Certainly it is not a proper subject here, where the size and constituency of the class is already known and where

the District Court did not need to know the precise identities of the putative members in order to be able to rule on the class motion.) The identification process, therefore, is not analogous to and cannot be compared with the discovery which is sometimes permitted before passing on a jurisdictional motion. It is an integral part of the notice procedure--no more, no less.

(2) The language of Rule 23(c)(2)--requiring "notice to all members who can be identified"--itself suggests that the process of giving notice and the process of identifying the members are part of the same procedure.

(3) The procedures actually being followed by the District Courts support this interpretation of Rule 23(c)(2). For example, the lower courts have, with increasing frequency, directed plaintiffs to arrange for and pay the costs of sending special notices to brokerage firms and other nominees in order to identify class members whose shares are held in "street name". See e.g., Berland v. Mack, 48 F.R.D. 121, 130 (S.D.N.Y. 1969); Herbst v. Able, 47 F.R.D. 11, 17-19 (S.D.N.Y. 1969); In re Memorex Security Cases, 61 F.R.D. 88, 103 (N.D. Cal. 1973); Stull v. Baker,

69 Civ. 2046 (S.D.N.Y.) (Order of Bryan, J., filed November 30, 1973); Popkin v. Wheelabrator-Frye Inc., 72 Civ. 3354 (S.D.N.Y.) (Order of Cannella, J., filed May 8, 1975).

(4) The argument put forward here by plaintiffs was also made to but apparently rejected by the Supreme Court in Eisen IV. See, e.g., Plaintiff's Br. in Eisen IV at 40-41 ("subjecting Respondents to the cost of notice does not differ in effect from requiring parties to make substantial expenditures to comply with discovery orders"); cf. 42 U.S.L.W. at 3493. There is no reason for this Court to reach a different conclusion.*

The question presented to the Court on this in banc rehearing cannot be brushed aside by characterizing the identification process as no more than an aspect of discovery which is subject to the sound discretion of the District Court judge. Whether a defendant is to be denied due process by being forced to finance the liti-

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* Plaintiffs in the instant case did, of course, conduct pre-motion discovery; however, they apparently decided not to request the new computer program information that they now assert defendants should pay to have prepared. One can reasonably infer from their decision that plaintiffs either knew that they were not entitled to the information as a normal incident of discovery or else realized that they would have to pay for its preparation.

gation against himself is not a matter for discretionary rulings.

C. Defendants' Purported Interest in Res Judicata Effects Does Not Justify Imposition of Costs

Plaintiffs and some courts have also put forward the argument that since a class action defendant has an interest in obtaining a judgment which is binding upon the entire class, it is not unreasonable to impose upon the defendant the costs of identifying and giving notice to the class. This contention is untenable.*

First, the supposed interest of defendants in

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* The College has not thought it necessary to respond in detail to plaintiffs' contention that, since it was allegedly defendants who were responsible for the class definition ultimately approved by the District Court, defendants should pay for identifying the members of the class. We note only that (i) defendants vigorously opposed plaintiffs' class motion, (ii) defendants unsuccessfully attempted to reduce the size of the class by having a cut-off date of April 25, 1969 instead of April 24, 1970, (iii) the defendant Fund, which alone was directed to pay the identification costs, has no direct interest in a broad res judicata effect, since plaintiffs and the class members are not seeking any relief from the Fund, and (iv) the class ultimately approved by Judge Griesa was the very class originally specified by plaintiffs in their complaints. Indeed, the only reason that any question arose as to defendants' responsiblity for the parameters of the class was that plaintiffs, in an "arbitrary" attempt to minimize their own costs, tried to redefine the class so as to eliminate 18,000 class members whom they purportedly represented and who Judge Griesa found were entitled to recovery to the same extent as other shareholder-members of the class.

a broad res judicata effect is, to say the least, highly speculative. That interest will be accommodated only if a judgment on the merits is in favor of the defendants. Inasmuch as the District Court is now proscribed from conducting any mini-hearings, it will not often be possible for the defendants to know whether they in fact have an interest in a broad res judicata effect. Second, and more important, the argument is completely illogical. It defies common sense to assert a defendant's interest in a wide res judicata effect as justification for imposing the costs of notice on him. In actions such as the case at bar, if the defendant does not bear the notice costs, the action is dismissed, and the defendant is spared not only the risk of an adverse judgment but also the cost of defending. See Dam, Class Action Notice: Who Needs It?, 1974 The Supreme Court Review 97, 120-21.

* * * * * * *

To urge that class action defendants--including those accused of breaching a fiduciary duty--cannot be compelled in most cases to pay the initial costs of identifying class members is not to say that such costs may never be imposed upon defendants. Special circumstances might exist which, when considered in the context of all

other relevant facts, justify departing from what the Supreme Court in Eisen IV characterized as "the usual rule". It is not the province of the College to define the "special circumstances" which might support a departure from "the usual rule", but whatever they may ultimately be determined by the Court to be, we respectfully submit that such circumstances are not present in the case at bar. We agree with Judge Hays that "the usual rule" should not be applied in such a way as to create "a serious potential for insulating fiduciary breaches from redress," Slip Opinion at 4597; but we also believe that the fiduciary's Constitutional, statutory and procedural rights must be given every consideration in determining whether such "serious potential" in fact exists. Merely because a suit has been commenced and accusations made against a fiduciary does not, in our opinion, create a presumption that he has engaged in some form of wrongdoing and, accordingly, does not justify imposing new and additional burdens on him.

Notwithstanding, we would suggest at least one situation where it might not be unreasonable to require a class action defendant initially to pay the costs of notification. If (i) there are sufficient safeguards to ensure that the defendant will be able to obtain reimbursement if he ultimately prevails, and (ii) it is less expen-

sive and more practical for the defendant, without prejudice, to identify and give notice to the class than it would be for the plaintiff, the court might be justified in departing from "the usual rule". A court might satisfy the first condition by requiring the plaintiff to post a bond; the second condition might be satisfied where, for example, inclusion of the notice with other materials would cause defendant no prejudice, and the class members were all presently on existing mailing lists maintained and regularly used by the class action defendant, as in an action against a public utility company where all potential class members were customers of the utility and were billed regularly.*

Neither of these conditions is satisfied here: it is no less expensive or more practical for defendants to identify the class members than for plaintiffs to do so, and plaintiffs have stated that they will not and cannot re-

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* This Court suggested in Eisen III that costs could be imposed upon the class action defendant in the situation described above when only the second condition existed--that is, even when appropriate safeguards for potential reimbursement were missing. See 479 F.2d at 1009 n.5. The College respectfully submits that this dictum fails to distinguish between the initial cost of notice and the method of giving that notice. Although it may be entirely appropriate for a court to minimize the expenses of notice by ordering the defendant to take certain action, such a directive should not be made unless it is clear that the defendant will be able to obtain reimbursement, in the event that he ultimately prevails in the litigation, of all incremental expenses resulting from the court's order. See generally Note, Managing the Large Class Action: Eisen v. Carlisle & Jacquelin, 87 Harv. L. Rev. 426, 442 (1973).

imburse defendants if defendants ultimately prevail. The majority of this Court's panel was therefore entirely correct in concluding that the District Court erred in directing the defendant Fund to pay the costs of identifying the class.

Conclusion

For the reasons stated above, the College respectfully submits that that part of the order of the District Court imposing on the defendant Fund the costs of extracting from computer tapes the names and addresses of the class members should be reversed and that the action should be dismissed if plaintiffs are unwilling or unable to pay those costs.

Dated: New York, New York
October 12, 1976

Respectfully submitted,

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AFFIDAVIT OF SERVICE

STATE OF NEW YORK)
. ss.:
COUNTY OF NEW YORK)

JOSEPH H. SCHNABEL, being duly sworn, deposes and says that:

He is an attorney and a member of the Bar of this Court.

On October 12, 1976, he caused the within BRIEF OF AMERICAN COLLEGE OF TRIAL LAWYERS AS AMICUS CURIAE to be served on the attorneys set forth in the annexed Schedule I, at their respective listed offices, by delivery of two copies of the brief to each of said attorneys.

Joseph H. Schnabel

Sworn to before me this
12th day of October, 1976

Joan Ann Annicaro

JOAN ANN ANNICARO
NOTARY PUBLIC, State of New York
No. 03-0129463
Qualified in Suffolk County
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Term Expires March 30, 1977

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Taussig v. Robbins, et al., Docket No. 75-7610

Shaev, et al. v. Hauser, et al., Docket No. 75-7611

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SCHEDULE I